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IN THE

# SUPREME COURT OF THE UNITED STATES

October Term, 1966

No. ~~952~~ 38

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER FERRY, INC.

*Petitioner*

*vs.*

C. GORDON ANDERSON, TRUSTEE

*Respondent*

**On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit**

## PETITIONER'S REPLY BRIEF

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## PETITIONER'S REPLY BRIEF

Three features of the respondent trustee's brief in opposition require comment:

1. At no point does the trustee address himself directly to our claim, supported by detailed

citations of cases in conflict, that this case merits certiorari review.

2. Instead, the trustee raises fact questions appropriate only to remand after rectification of the procedural errors that we say kept essential facts out of the record.

3. At no point does the trustee so much as mention the Securities and Exchange Commission, much less take account of the circumstance that on every major issue in this long proceeding, both on law and on facts, the SEC has agreed with us that the course of the proceedings below has violated the basic protections of Chapter X.

The first two are standard distraction tactics for any respondent in certiorari. The third is peculiar to Chapter X and to the advisory role of the SEC. This responsible public agency, "about the only wholly disinterested party in the proceeding", *Finn v. Childs Co.*, 181 F2d 431, 438 (CA2, 1950), an active participant from the beginning, after close familiarity with the entire proceedings and careful study and report, rejected each of the assertions of fact and the applicability of each of the contentions of law on which respondent trustee rests (references collected Pet. 7, 8, 9, 10, 12, 13, 15, 16, 17, 18, 29, 31).

A. *The trustee's treatment of the questions of law:*— The trustee sidesteps every question of law that the petition presents for certiorari review. He cites no law at all on our contention that the decision below is in conflict with the specific cases we cited from other circuits and

from this Court as to the error of retrospective valuation (Pet. 33), the error of summary findings without hearing on laches (Pet. 32), the error of failure to investigate responsible fraud charges against dominant creditors (Pet. 30) and the error of treating heavy creditor approval (Pet. 29) or assumed lack of standing of the complaining stockholders (Pet. 27) as precluding review of the fairness of the plan.

To our contention that the decision below is in conflict with a specifically cited decision of this Court as to the creditor position of defrauded stockholders (Pet. 31) he replies only that there is Michigan dictum that supports him (Br 11). To our contention that the acceptance of compromises here is procedurally invalid under specific decisions of two other circuits because of inadequate record disclosure quite apart from the merits, the trustee replies only with the familiar general law that compromises are discretionary (Br 10). But the precise question is whether compromises whose basis is not made manifest on the record are saved as discretionary, and the decisions we cited say no (Pet. 32).

Likewise where our petition addresses itself to the exercise of this Court's Rule 19(b) supervisory power over the trustee as a court officer, simply because the courts below have demonstrated a lack of alertness and sensitivity to the imperative need for making this officer perform his statutory duties and for enforcing the procedural protections of Chapter X (Pet. 25-6, 34), the trustee replies only that the courts below approved what he did (Br 6, 7, 9). This begs the question, which is whether they should have so approved.

Thirty years ago the SEC, in the monumental report that led to the procedural reforms embodied in Chapter X, pointed out how easy it is for those who dominate a bad reorganization to make it look good enough for a trusting court to approve:

> "Outwardly reorganizations may appear to be expeditious, economical, fair, and honest. Often, however, those characteristics will only be illusions. Reorganizers will merely have dressed the procedure in familiar and respectable garb", Securities and Exchange Commission, *Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees*, Part I, p5 (1937).

The unabashed trustee makes the bland statement that the Petition makes no attack on the "*procedure* described in the Bankruptcy Act for the preparation, consideration, approval, acceptance and confirmation of a plan of reorganization" (Br 6, his emph.). But most of the complaints that the Petition brings to this Court are that we were indeed deprived throughout of the *procedural* protections of Ch X — e.g., failure to require record disclosure under General Orders 33 and 52(2) of the basis of compromises (Pet. 16, 32), failure to require the trustee to investigate under §167 (Pet. 30), failure to lend the court's discovery process to let the Committee bring into the record what its own investigation had disclosed (Pet. 12), ultimately discharging the Committee for stubborn disobedience in presuming to raise these contentions that the District Court had erroneously deemed foreclosed as a matter of the law of the case (Pet. 12).

The trustee makes the standard contention that the District Court's findings were based upon substantial evidence and should not be disturbed unless clearly erroneous (Br 6). Of course. But substantial evidence in the record is not enough when as here erroneous procedures prevented evidence to the contrary from coming into the record.

Moreover findings in Chapter X proceedings do not come to this Court clothed with the heavy presumption of regularity accorded most trial court action. In the Chapter X field, when the SEC exercises as here its statutory option to participate in a reorganization by way of appearance, advisory reports, and joining in appeals,[1] the shoe may be on the other foot. As the Second Circuit put it in *Conway v. Silesian Amer. Corp.*, 186 F2d 201, at 202-203 (CA2, 1950), where the presumption of trial court regularity was unsuccessfully urged in support of approval of a compromise plan the SEC had found — as here — unfair:

> "But we are not justified in thus oversimplying this difficult problem, so much more one of forecasting the future than of restating the past. Naturally careful consideration is due the conclusion of the able district judge who has had this lengthy reorganization so long under his control. At the same time we cannot overlook the fact that the governmental agency charged with substantial responsibility in the premises, the Securities and Exchange Commission, had made an extensive investigation resulting in a detailed and helpful report with a reasonable conclusion which the trial judge has rather summarily re-

[1]The Commission, however, "may not appeal or file any petition for appeal", Bankruptcy Act, §208 (11 USC §608).

> jected. If the considered findings of this agency with so much better facilities for investigation than those possessed by either this or the trial court, are to have any force beyond their initial impact below, then we think that they will largely offset the usual presumption accorded a decision of first instance. Otherwise much of the statutory purpose in creating an expert body for the consideration of technical problems will be set at naught. Compare 6 Collier on Bankruptcy ¶7.30, 14th Ed. 1947. We have elsewhere stressed the importance of due regard for Commission findings, Finn v. Childs Company, 2 Cir., 181 F2d 431, 438; and we are clear that here, too we must give weight to the detailed evaluation of the facts made by this reliable and experienced public agency and to the conclusion reached, even though this was not accepted by the trial judge".

See also on the counterbalancing effect of the SEC views, *Ashbach v. Kirtley*, 289 F2d 159 (CA 8, 1961); *Scribner and Miller v. Conway*, 238 F2d 905 at 907 (CA2, 1958); *In re Solar Mfg. Corp.*, 215 F2d 555 at 562 (CA3, 1954); *Chicago & West Towns Rys. v. Friedman*, 230 F2d 364 (CA7, 1956).

B. *The trustee's injection of questions of fact:* — Within the limits of time and paper appropriate to reply brief at the petition stage we may shortly tick off a couple of major points of fact that the respondent's brief misleadingly presents.

i. *The lack of Merrill-Stevens fraud investigation:* — Responding to our complaint of the District Court's failure

to hear our fraud charges against the Merrill-Stevens claim, the trustee would have the Court believe that we misstated the facts when we said (Pet. 8-9, 13, 16) that there had been neither investigation nor hearing on these charges. But the very record passages that the trustee cites show that the investigation and hearing he mentions took place before the end of 1961, with leave to the Committee to pursue the matter further (II, 37). It was only thereafter, in February 1962, that the Committee submitted its 40 pages of detailed allegations on subjects new to the record, such as Merrill-Stevens conspiracy with the old management and with the Shaffer-Spitzer-Caplan principals in market-rigging; and it was these allegations that we complain were ignored (record citations collected, Pet. 8-9). And likewise investigations made by the trustee in 1961 will not excuse refusal to look at evidence of the aspects of the fraud we discovered only in 1965 by way of incriminating documents the trustee said he had never seen (record citations collected, Pet. 12). SEC concurrence in our basic position on these points is noted at Pet. 9, 12-13.

ii. *The assurances of the trustee's tenure:* — The trustee attempts to disown his conflict of interest in advancing a contested plan that contemplated keeping him on in postreorganization management. He points to the petty fact that the final text of the reorganization plan contained no explicit provision for a long-term contract and substantial stock options (Br. 5, 8), although this was initially explicit and later replaced by transparent euphemism (ib.; Pet. 14, 25). He also argues that a creditors' committee rather than himself was the titular author of the original plan. In view of the concentration of general creditors' claims into the hands of the tugboat operator

and the insurance broker who are the trustee's patronage beneficiaries and share control with him under the plan (Pet. 9), it is hardly material whether it was the trustee who was catspaw for the creditors' committee or they for him. At that, the creditors' committee plan, bearing a management contract rider, was formally approved by the trustee (II, 695, 707, 710).

The essential point is that the Court of Appeals in remanding on the appeal from the 1962 plan had rejected the SEC's position (Advisory Report quoted Pet. 13 n) that inherent self-interest bars a trustee from accepting postreorganization management status under a contested plan; but that court had ruled that "a trustee would not be disinterested within the meaning of 11 U.S.C.A. §538 if the proponents of a plan assured him of emoluments and security ***", 334 F2d 118, 119-120; Pet. App. 4a-5a; Cf. 364 F2d 936, Pet.App. 8a. On this clearly open issue of "emoluments and security", therefore, we tendered proof and sought a hearing, which the District Court denied on the incorrect claim of law of the case; and though the Court of Appeals recognized that this ruling was wrong, it let the denial of hearing stand without remedy (Pet. 13-14). It was and is our submission that a trustee cannot be deemed independent when inquiry into his independence has been so suppressed.

Moreover we have noted that the broad form of the issue whether the trustee should be prophylactically barred even without proof of "emoluments and security" is still open if certiorari is granted (Pet. 14 n). Whether in the broad or the narrow form, without or with such proof, the question whether a trustee may perpetuate himself in postreorganization management is one of basic importance

in the administration of the statute, never yet resolved and here presented on a record adequate for provident review.

iii. *The earnings record after the plan:* — The trustee's brief regards it as a triumphant confirmation of the wisdom of the District Court in keeping valuation low by refusal to recognize already visible trends of the company's postreorganization future, that the net profits reported by the trustee dropped after a rise (Br 2-3). The record shows that notwithstanding an unanticipated rate war (III, 127) revenues continued after the hearing to grow just as the Committee's expert witness had predicted they would (II, 249; III, 231-2), but that cost increases ate them up.

These cost increases are not what they appear to be, however. They are the sum of a) bookkeeping manipulations established by the SEC and admitted by the trustee's auditors (II, 921-3; III, 283);[2] b) padding the costs by reorganization expense which the trustee has refused to disentangle from operating expense, a substantial factor certain in fact but uncertain in amount (II, 1077-8; III, 183);[3] c) milking the profits in favor of the trustee's patronage beneficiaries, another substantial factor certain in fact but uncertain in amount (II, 950-54; III, 90);[4] and d) per-voyage cost increases attributable to the reorganization itself.

These per-voyage cost increases arise solely from the

[2]At least 5 figures annually (III, 283).

[3]Estimated at 6 figures annually (II, 1077-8).

[4]Estimated in 6 figures annually, id. The Court will note that a 6 figure distortion of the annual profit rate represents a 7-figure distortion of the valuation. Either of the latter two alone could make the difference between solvency and insolvency.

fact that the reorganization was protracted. On loss of the old company's self-propelled vessels through foreclosure, the trustee continued a makeshift operation with concededly obsolete and expensive LSTs. He had to increase his fleet of them to 5, from the 3 with which he was making his 1962 profits (II, 225; III, 152), in order to serve the constantly increasing traffic tendered him, for under reorganization conditions he could not (or said he could not) finance the more modern vessels we had urged him to buy (II, 1079-82) and which he had already programmed in detail to replace the LSTs—after reorganization (III, 126, 138, 139, 148, 153-4). Thus it is the continuance of the reorganization that has itself aggravated the inefficient high cost operating conditions of the reorganization period, and has prevented achievement of the efficient postreorganization operating conditions which the trustee has been able to project with business-like detail for all purposes except hearings on valuation (cf. SEC Report, quoted Pet. 18). Only by ignoring this can the District Court's valuation technique, improper as a matter of law (citations collected, Pet. 33) be conceived to have been confirmed by the facts.

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We begrudge having to enter at all on these factual questions where we raised only questions of law, for an orderly presentation would defer the facts to the remand. The very pursuit of multiple fact issues beclouds the few important questions of Chapter X administration we sought to tender for review. Yet were we to let the trustee's fact contentions pass unchallenged we would risk a tacit admission of having attempted to mislead the Court by shrill clamor about nothing. It is indeed because the issues of a reorganization — and here one so bungled that

two out of three plans approved so far have had to be vacated — tend to be complicated by an accretion of factual matters that are not easy to review on the merits at any appellate level, that rigorous compliance with the procedures commanded by Chapter X becomes so necessary.

C. *The position of the SEC:* — Because of the surprising fact already mentioned, that the respondent trustee has chosen to shrug off, without so much as mention of the name of the agency, the record that the SEC has supported us throughout and in cited detail, we summarize that support in its broad outline by now adopting and setting out verbatim the SEC's index of the 64-page brief it filed before the Court of Appeals, on our appeal from the third (1965) plan directly involved in the present petition for certiorari.


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